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8 **UNITED STATES DISTRICT COURT**
9 **SOUTHERN DISTRICT OF CALIFORNIA**
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11 PHL VARIABLE INSURANCE CO.,
12 Plaintiff,
13 v.
14 THE ABRAMS FAMILY IRREVOCABLE
15 LIFE INSURANCE TRUST, by and
16 through its trustee, H. Bruce Abbott,
17 Defendant.

Case No. 10cv521 BTM (POR)

**ORDER RE MOTION TO DISMISS
FIRST AMENDED COMPLAINT**

17 Defendant The Abrams Family Irrevocable Life Insurance Trust ("Trust") moves to
18 dismiss a declaratory judgment action brought by Plaintiff PHL Variable Insurance Company
19 ("Phoenix"). For the reasons that follow, this motion is **GRANTED** without prejudice.
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21 **I. BACKGROUND**

22 On November 24, 2007, Defendant submitted an application to Phoenix seeking a life
23 insurance policy insuring the life of Howard Abrams. (First Amended Complaint ("FAC") ¶
24 19) Defendant represented that Abrams had a net worth of \$23,652,000 and an annual
25 earned income of \$150,000. (FAC ¶ 19) As part of the application process, Defendant also
26 executed a Statement of Client Intent form which stated that the insurance was sought for
27 estate planning purposes, that premiums would not be financed, that Abrams would be the
28 funding source for the premiums, and that there was no understanding that the policy would

1 be sold and/or transferred to third parties. (FAC ¶ 22) Phoenix accepted this application and
2 issued a life insurance policy to the Trust for a \$10,000,000 death benefit with an effective
3 date of March 15, 2008. (FAC ¶ 24)

4 Nearly two years later, on March 3, 2010, Phoenix sent letters requesting documents
5 from Abrams, the Trustee, and the insurance agent who sold the Policy to verify that the
6 financial representations contained in the application were true and correct. (FAC ¶ 25;
7 Mem., Exh B) These letters received no response. (Mem. at 8) Nevertheless, Phoenix
8 asserts that based on its "own independent investigation," Defendant had misrepresented
9 his net worth and annual income on this application. (FAC ¶ 25) Phoenix also claims "[u]pon
10 information and belief" that the policy was procured for an illegal purpose of re-sale to
11 strangers on the secondary market. (FAC ¶ 6)

12 On March 10, 2010—four days before the expiration of the policy's two-year
13 contestability period, Phoenix brought this declaratory judgment action under 28 U.S.C. §
14 2201 seeking a judgment that the policy is null, void, and rescinded *ab initio* due to fraudulent
15 and/or material misrepresentations and omissions that Defendant made on the life insurance
16 application.¹ (FAC ¶ 29) Phoenix also seeks a declaratory judgment pursuant to Section
17 483(c) of the California Insurance Code that Defendant is not entitled to a return of policy
18 premiums due to actual fraud or in the alternative, a judgment allowing Phoenix to retain
19 premiums to the extent that it will allow Plaintiff to return to its pre-contract position. (FAC
20 ¶ 31)

21 22 **II. STANDARD**

23 To survive a motion to dismiss under Fed. R. Civ. P. 12(b)(6), a complaint must meet
24 the requirements of Rule 8(a)(2), which requires the pleader to make a "short and plain
25 statement of the claim." This motion should be granted only where a plaintiff's complaint
26 lacks a "cognizable legal theory" or sufficient facts to support a cognizable legal theory.

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28 ¹ The Court has jurisdiction over all parties of this lawsuit on grounds of diversity under
28 U.S.C. § 1332(a)(1).

1 *Balistreri v. Pacifica Police Dept.*, 901 F.2d 696, 699 (9th Cir. 1988). When reviewing a
 2 motion to dismiss, the allegations of material fact in plaintiff's complaint are taken as true and
 3 construed in the light most favorable to the plaintiff. See *Parks Sch. of Bus., Inc. v.*
 4 *Symington*, 51 F.3d 1480, 1484 (9th Cir. 1995). Although detailed factual allegations are
 5 not required, factual allegations "must be enough to raise a right to relief above the
 6 speculative level." *Bell Atlantic v. Twombly*, 550 U.S. 544, 127 S.Ct. 1955, 1965 (2007).
 7 "A plaintiff's obligation to prove the 'grounds' of his 'entitle[ment] to relief' requires more than
 8 labels and conclusions, and a formulaic recitation of the elements of a cause of action will
 9 not do." *Id.* "[W]here the well-pleaded facts do not permit the court to infer more than the
 10 mere possibility of misconduct, the complaint has alleged - but it has not show[n] that the
 11 pleader is entitled to relief." *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1950 (2009) (internal quotation
 12 marks omitted).

14 III. DISCUSSION

15 Defendant asserts two main grounds for dismissal: (1) Plaintiff's claims lack factual
 16 support sufficient to comply with Fed. R. Civ. P. 8(a)(2)'s pleading requirements; and (2)
 17 Plaintiff violated California law by failing to contest the policy within two years. Defendant
 18 also seeks dismissal under Rule 11(b) and in its reply brief, invites the Court to impose
 19 sanctions under Rule 11 *sua sponte*. The Court addresses these arguments in turn.²

21 A. Fed. R. Civ. P. 8(a)(2)

22 Plaintiff brings a single count for rescission based on allegations of material
 23 misstatements in Abrams' insurance application. These allegations fall short of Rule
 24 8(a)(2)'s pleading requirement, as clarified in *Twombly* and *Iqbal*.

25 First, Plaintiff attempts to substantiate its assertion that Abrams misstated his net
 26 worth and annual income on the grounds that (1) Defendant did not respond to a request
 27

28 ² Because the Court grants Defendant's motion to dismiss, it need not address the
 argument that Plaintiff cannot seek to retain the premiums if the policy is rescinded.

1 made nearly two years after his application was accepted to verify that these financial
 2 representations were correct and (2) its “own independent investigation did not reveal any
 3 basis on which a person could reasonably conclude that Abrams had a net worth of
 4 \$23,652,000 or annual earned income of \$150,000 on the date of the application.” (FAC ¶
 5 25)

6 As to the former ground, Defendant’s failure to respond to Plaintiff’s request for
 7 documentation, alone, does not mean that representations in Defendant’s application were
 8 false when made. Plaintiff does not raise a breach of contract claim, and thus, its assertion
 9 that Defendant had a contractual obligation to respond to this letter does not control the
 10 question of whether Plaintiff stated a claim for rescission based on material misstatements.

11 As to the latter ground, Plaintiff provides no details as to what its “independent
 12 investigation” entailed and the facts the investigation uncovered which led it to conclude that
 13 Defendant’s statements in the application were false. Without these details, Plaintiff states
 14 nothing more than a legal conclusion that it was the victim of fraud. Such a bare legal
 15 conclusion is insufficient to meet Rule 8’s pleading requirements. *See Eason v. IndyMac*
 16 *Fed. Bank, FSB*, No. CV 09-1423, 2009 U.S. Dist. LEXIS 82523 (D. Ariz. Sept. 2, 2009)
 17 (citing *Iqbal*, 129 S.Ct. at 1949).

18 Second, Plaintiff asserts “[u]pon information and belief, the policy at issue in this case
 19 was procured from Phoenix in furtherance of a STOLI [stranger-owned life insurance policy]
 20 scheme.”³ (FAC ¶ 4) However, Plaintiff’s complaint fails to provide any details to show that

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 22 ³ A commentator provides the following summary of STOLI schemes: “STOLI
 23 transactions occur when elderly persons who do not already own life insurance decide to
 24 purchase a policy at the behest of investors and brokers. The investors initiate the life
 25 insurance transactions with strangers at the point of sale. . . . The target population is
 26 wealthy people who are 65 years or older with a limited life expectancy. The targeted
 27 consumer agrees to purchase a life insurance policy with a large face value with funds
 28 provided by the investor through an outside financial institution. A two-year non-recourse
 loan is typically used to purchase the policy and to fund the insured’s payment of premiums.
 At the end of two years, the policy is usually assigned to the investor. The assignment
 functions, to some extent, as a repayment of the initial loan plus interest. While assignment
 of the policy is not technically required, it is inevitable given the size of the loan plus interest
 and premiums an insured would have to repay and continue to pay if he chose to maintain
 the policy.” Eryn Matthews, Note, *STOLI on the Rocks: Why States Should Eliminate the*
Abusive Practice of Stranger-Owned Life Insurance, 14 CONN. INS. L.J. 521, 525-527 (2008).
 Plaintiff asserts that such policies procured by the insured for resale on the secondary market

Defendant bought the policy for the purpose of re-selling it to strangers on the secondary market or any other details to show how Defendant's Statement of Client Intent form was false or misleading. "The Federal Rules do not require courts to credit a complaint's conclusory statements without reference to its factual context." *Iqbal*, 129 S. Ct. at 1954., Plaintiff's mere assertion of an illegal STOLI scheme is not sufficient to survive a motion to dismiss.

Therefore, the Court **GRANTS** Defendant's motion to dismiss without prejudice. Because, as set forth below, the Court denies Defendant's motion to dismiss on the ground that Plaintiff failed to properly contest the policy within the meaning of California's contestability statute, Plaintiff's failure to provide factual support sufficient to state a claim under Fed. R. Civ. P. 8(a)(2) may be cured in an amended complaint.

B. Contestability Statute

As an alternative ground for dismissal, Defendant argues that Plaintiff failed to comply with California's contestability statute, which requires that a life insurance policy issued in the state contain a provision stating that the policy cannot be contested more than two years after issuance. See Cal Ins Code § 10113.5. However, Defendant does not dispute that the instant action was brought within the expiration of the contestability period. (See Mem. at 2 ("[F]our days before the expiration of the Policy's two-year contestability period, PHL commenced this action.)) It appears to be well-settled that commencement of a suit to cancel a policy within the prescribed period constitutes a "contest" within the meaning of the statute. See *New York Life Ins. Co. v. Hollender*, 38 Cal. 2d 73, 78 (1951) ("[T]he insurer must make its 'contest of the policy' within the prescribed period, either by the institution of a suit to cancel the policy or by setting up misrepresentation or fraud in the procurement of the policy as a defense in an action brought by the insured or the beneficiary.") (emphasis added); see also 17 Couch on Ins. § 240:97 (2010) (same); 44 Am. Jur. 2d Insurance § 778

are "illegal wagering contracts that lack an insurable interest at inception" and are void *ab initio*. (FAC ¶ 3)

1 (“[I]f, within the contest period, an insurer brings suit to relieve itself from liability under a
2 policy, the insurer has made a contest.”).

3 Defendant does not cite any authority which states that commencement of a lawsuit
4 is an insufficient means to contest a policy. Instead, Defendant argues that the purpose of
5 the contestability statute is to ensure that “life insurers. . . conduct an investigation and
6 discover facts justifying rescission prior to the end of the two year period” (Mem. at 9) and
7 that allowing an insurer to commence an action without discovering facts supporting a
8 rescission claim is incompatible with this purpose (Reply at 6). However, the Court need not
9 grant Defendant’s motion to dismiss on this ground in order to support this legislative goal.
10 The requirement, articulated in *Iqbal* and *Twombly*, that a complaint contain more than
11 conclusory statements and legal conclusions ensures that insurers cannot perform an end-
12 run around California’s contestability statute by using a lawsuit as a fishing expedition to
13 discover facts showing fraud after the prescribed time period. Indeed, in order for Plaintiff
14 to amend its complaint to cure the deficiencies cited above, Plaintiff will have to show that
15 it had discovered facts that would justify rescission prior to the end of the contestability
16 period. Accordingly, Defendant’s motion to dismiss on the ground that Plaintiff failed to
17 comply with California’s contestability statute is **DENIED**.

18 19 **C. Sanctions Under Rule 11**

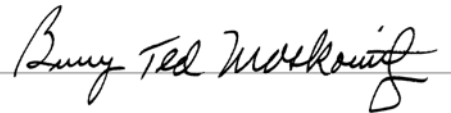
20 Defendant asserts that the complaint does not satisfy Fed. R. Civ. P. 11(b) and seeks
21 a sanction of dismissal. (Mem. at 1, 5) However, Defendant did not comply with either Rule
22 11(c)(2)’s requirement that “[a] motion for sanctions must be made separately from any other
23 motion” or the rule’s “safe harbor” requirement, which provides that a party seeking sanctions
24 must give the opposing party twenty-one days after service of the motion to “withdraw or
25 appropriately correct[]” the challenged paper, claim, defense, contention, or denial. The safe
26 harbor provision is strictly enforced. *Holgate v. Baldwin*, 425 F.3d 671, 678 (9th Cir. 2005).
27 Because Defendant did not comply with the safe harbor provision, Defendant’s motion for
28 sanctions is denied.

1 **IV. CONCLUSION**

2 For the reasons discussed above, Defendant's motion to dismiss the First Amended
3 Complaint is **GRANTED**. Plaintiff's First Amended Complaint is **DISMISSED** for failure to
4 satisfy Fed. R. Civ. P. 9(b)'s heightened pleading standard. The Court grants Plaintiff leave
5 to file a Second Amended Complaint curing the deficiencies identified in this Order. If
6 Plaintiff chooses to file a Second Amended Complaint, it must be filed within 20 days of the
7 entry of this order. Failure to do so will result in a final judgment of dismissal.

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9 **IT IS SO ORDERED.**

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11 DATED: November 5, 2010

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13 Honorable Barry Ted Moskowitz
14 United States District Judge
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